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## **The Effects of Profitability, Leverage, and Liquidity on Financial Distress on Retail Companies Listed on Indonesian Stock Exchange**

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### **ABSTRACT**

The study aims to find out the influence of profitability variables (Return On Assets), Leverage (Debt To Asset Ratio) and liquidity (Current Ratio) on Financial Distress on retail companies listed on the 2014-2018 period Indonesian Stock Exchange. The population of this study is the entire company contained on the Indonesian Stock Exchange listed retail company of the period 2014-2018. The research sample consists of 21 companies used by purposive sampling methods and taken that meet with criteria from predetermined research samples. The data analysis method used is panel data regression analysis (Random Effect) with a significance level of 5 percent. Based on the results of the research that has been conducted led to that, simultaneously Profitability, Leverage and Liquidity variables have an effect on Financial Distress. Partially variable Profitability has a significant positive effect on Financial Distress, Leverage variables have a significant positive effect on Financial Distress, and negatively significant negatively influential Liquidity variables on Financial Distress. The magnitude of the influence of Profitability, Leverage, and Liquidity on Financial Distress amounted to 98.87 percent, while the rest amounted to 1.13 percent was affected by other variables outside of research.

Keywords: Profitability; leverage; liquidity; financial distress

### **INTRODUCTION**

The pace of growth of the world's economic conditions is undergoing considerable progress each year, various ways businesspeople do to maintain and develop competitive advantages with their competitors (Horne, J.C. dan Wachowicz, 2007; Mulyanti, 2016). The company's competition of one with the other is getting tighter and tighter, thus causing the costs incurred by the company to also get bigger. Factors that can make the company maintain its business activities continuity also need to be noticed by understanding about business failures, as businesses always have the disadvantage of having difficulty even financial failures (Rengifurwarin et al., 2018).

The company constitutes an organization founded with the goal of earning a huge profit. In addition the company also focused on the company's survival to continue going concern. The assumption of going concern used a business entity in running its efforts. With the existence of a going concern an entity is considered capable of sustaining its efforts in the long run and will not be liquidated in the short term (Prabowo & Wibowo, 2017). Management capabilities within a company in order to maintain the company's condition to continue going concern will spare the company from the occurrence of financial difficulties (financial distress) which could cause business bankruptcy to be brought to a later date. The initial stage of business bankruptcy that

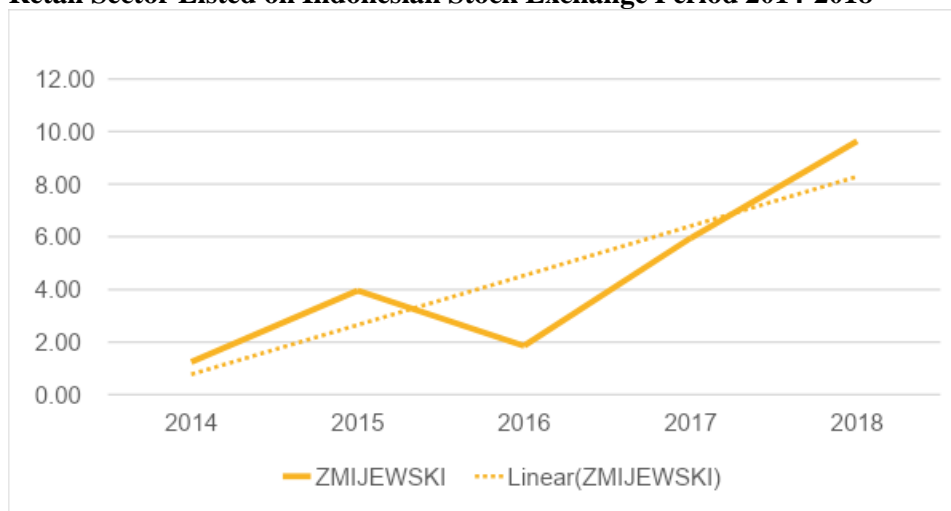
occurs within the company is usually prefixed with the occurrence of financial difficulties (Opler & Titman, 1994; Outecheva, 2007).

The shift of community shopping style to a signalized electronic trading platform co-influenced the sales of fast moving consumer goods (FMCG) in modern retail. However, in general the development of modern retail ventures in Indonesia, seen from the magnitude of consumption of FMCG products, during April 2018—April 2019 still grew positive by 1.8% with modern retail growth of 6.6%. Nevertheless, modern retail businesses will still record growth in Indonesia. (economics.bisnis.com).

Methods for predicting financial distress have been done enough as well as providing different results each of his researches, a wide variety of bankruptcy prediction methods have been developed by some experts, among others the (Miller & Springate, 1978) and (Zmijewski, 1984) methods. (Huda et al., 2019)) stated that for the Zmijewski model it can be inferred is the best model because it has the lowest error rate than both the altman and springate methods. According to BAPEPAM in (Setiawati, 2017) states that the Zmijewski method combines various financial ratios together, then there exists a ratio of pre-interest and tax to total assets of incomes the best indicator of knowing the occurrence of bankruptcy and providing suitable coefficients to combine variables—independent variables. That would make the proportions that would be judged more valid for predicting financial distress. The following are described financial distress conditions occurring in the retail sector listed in the 2014-2018 period BEI as follows:

**Figure 1.**

**Graph Conditions of Financial Distress Proxyed With Zmijewski on the Retail Sector Listed on Indonesian Stock Exchange Period 2014-2018**



Source : Data Processing Results

From the chart it can be seen that financial distress conditions on the retail sector listed in the 2014-2018 period BEI tend to experience increases. In the period 2014-2015 saw a last increase in the period 2015-2016 in decline and in the period 2016-2018 experienced a fairly significant re-ascension. Based on the calculation of zmijewski the company underwent

financial distress when the value of *zmijewski* was more than 0 and it can be seen that the value of *zmijewski* showed a value of more than 0 meaning the period 2013-2018 on the retail sector company was predicted to be financial distressed. Then, the trendline can be seen that in the 2014-2018 period showed a fairly significant increase in each year.

The swindling conditions of retail businesses in Indonesia are strongly related to financial distress where many retail companies are already in the financial distress zone but can remain to date. One cause of financial distress is the existence of mismanagement, poor financial decisions whereas effective management planning can help delay the decline and failure (Andersen et al., 2013; Saunders & Cornett, 2014; Wong, 2006)

Profitability is a ratio that measures the ability of a company to generate profits (Anderson et al., 1994; Olalere et al., 2017; Ponsian, 2014). According to (Brigham & Houston, 2012)) to measure financial performance, the ratio used that is the profitability ratio because this ratio has covered debt ratio, activity ratio as well as liquidity ratio. The profitability ratio consists of ROA (Return On Assets) which is the ratio showing the ability of the entire assets that exist and are used to make Return on Assets (ROA) profits is the result of comparisons between EBIT and total assets, which in the retail company it shows that in Indonesia in recent years there have been several companies that closed their outlets based on the assets it has and ROA are also able to measure the ability of the company to generate profits in the past years projected in the foreseeable future.

The leverage ratio according to (Hery, 2015) represents the ratio used to measure the extent to which the company's assets are financed with debt. That is, the leverage ratio is a ratio used to measure how large the debt burden a company should bear in the order of asset fulfillment. The commonly used leverage ratio on research is debt asset ratio. Debt asset ratio is calculated by the way total debt is divided by total asset, viewed from the development of the retail company that the asset owned is dwindling and total debt is getting higher which can get some companies to close its business outlets.

The liquidity ratio is a ratio that measures the ability of a company to meet its short-term obligations. One of the liquidity ratios is current ratio where it describes the company's ability in paying off short-term liabilities by utilizing its smooth assets. According to (Munawir, 2005) current ratio is a ratio that indicates the safety level (margin of safety) of short-term creditors, or the ability of the company to pay those debts. Current ratio is a comparison of the smooth assets with the smooth debt, whereby an asset within this retail company has increasingly shrinking value and an increasingly high debt that can get some companies to close its business outlets.

## **METHOD**

According to (sugiyono, 2014) the object of research is an attribute or trait that has certain variations set by researchers to study and then draw conclusions. The research object the author applied according to the one to be researched is financial distress retail companies with Profitability, leverage and liquidity ratios that are proxied with ROA, DAR and CR on retail companies listed on the Indonesian Stock Exchange (BEI) period 2014-2018. The analysis unit is something to do with the focus studied. Analysis units can be objects, individuals, groups, regions and specific times according to the research focus. The study used a company or organizational analysis unit, namely the retail company listed on the Indonesian Stock Exchange (BEI) period 2014-2018.

The population in the study was a company listed on the Indonesian Stock Exchange (BEI) period 2014-2018. The number of populations in this study was 25 companies. Samples in this study used non-probability sampling methods, namely non-random sample retrieval methods with purposive sampling selection techniques

The method of data analysis in this study was panel data regression analysis. Panel data is a composite of cross section data and time series (time series) which are a number of observation variables over a number of categories and collected within a given period of time. This panel data regression test is used to know the relationship between independent variables with dependent variables. Testing will be done through the following stages: classical assumption testing, multiple linear regression analysis, determination coefficient, simultaneous and partial hypothesis testing. The testing was conducted with the help of Eviews 10 software. Multiple linear regression is used to test the influence of two or more independent variables on a single dependent variable and is generally expressed in the equation as follows:

$$\text{Adhes} = a + \_1 X\_1 + \_2 X\_2 + \_3 X\_3 + \mu$$

The research's linear aggression uses a panel data regression model with independent variables namely Profitability, Leverage and Liquidity to Financial Distress, whereby such regression models are described through the equation as follows:

$$a + \_1 \text{ROA\_it} + \_2 \text{DAR\_it} + \_3 \text{CR\_it}$$

## RESULT AND DISCUSSION

The liquidity ratio is a ratio that measures the ability of a company to meet its short-term obligations. To be able to fulfill its obligations, then the company must have tools to pay which are smooth assets whose amounts must be far greater than those obligations to be paid by the company. When the company is able to fund and pay off its short-term obligations well then the company's potential to experience financial distress will get smaller. In contrast, if the company is unable to pay off its short-term obligations then the more likely the financial distress is.

Random Effect Model is used as an estimation of panel data leading to the conclusion that independent variables of profitability, leverage, and liquidity jointly affect Financial Distress. Results of regression parameter estimation using the random effect cross-section model approach:

**Table 1.**  
**Statistic Analysis**

Dependent Variable: FD

Method: Panel Least Squares

Date: 11/11/19 Time: 13:42

Sample: 2014 2018

Periods included: 5

Cross-sections included: 15

Total panel (balanced) observations: 75

Variable	Coefficient	Std. Error	t-Statistic	Prob.
	1130723.	231.10	4.10621	.000
ROA	5.086839	0.223380	22.77215	0.0000
DAR	7.105715	0.233332	30.45329	0.0000
CR	-0.209513	0.084672	-2.474397	0.0163

Effects SpecificationCross-section fixed (dummy variables)

R-squared	0.988715	Mean dependent var	-164107.0
Adjusted R-squared	0.985349	S.D. dependent var	169734.4
S.E. of regression	20545.07	Akaike info criterion	22.90419
Sum squared resid	2.41E+10	Schwarz criterion	23.46039
Log likelihood	-840.9072	Hannan-Quinn criter.	23.12628
F-statistic	293.7504	Durbin-Watson stat	1.414027
Prob(F-statistic)	0.000000		

Source : Data Processing Results

Based on the table there are constant values and regression coefficients, so that can be formed the regression equation as follows:

$$Y = -1130723 - 5,086839 X_1 - 7,105715 X_2 - 0.209513 X_3 + e$$

The above equations can be interpreted as follows:

0 = 1130723 meaning if the variable ROA ( $X_1$ ), DAR ( $X_2$ ), CR ( $X_3$ ), is zero-valued (0), then the variable Financial Distress (Y) will be worth 1130723 units. Or dengan another sense, the line-regression line will cut the Y axis at point 1130723.

1 = 5,086839 in effect if the variable ROA ( $X_1$ ) increases by one unit and the other variable is constant, then the variable Financial Distress (Y) will decrease by 5,086839 units.

2= 7,105715 s means if the DAR variable ( $X_2$ ) increases by one unit and the other variable is constant, then the Financial Distress (Y) variable will decrease by 7, 105715 units.

3= - 0.209513 s mean if the CR variable ( $X_3$ ) increases by one unit and the other variable is constant, then the Financial Distress (Y) variable will decrease by -0.209513 units.

Based on the value obtained table F count by 293,7504. This value will then be compared to the F value in the F distribution table. For  $\alpha = 5\%$ ,  $df_1=k=3$ , and  $df_2=n-k-1=75-3-1=71$  is obtained the F table value of 2,73. Due to the value F count greater than the value F table ( $293,7504 > 2.82$ ), then  $H_0$  is denied and  $H_1$  is received, meaning that ROA( $X_1$ ), DAR( $X_2$ ), CR( $X_3$ ) are jointly as significant influences on Financial Distress(Y).

## CONCLUSION

Affirmative Development of profitability, leverage and liquidity to financial distress on retail companies listed on the 2014-2018 period Indonesian Stock Exchange is as follows:

Affirmative Development of profitability, leverage and liquidity to financial distress in Indonesian Stock Exchange listed retail companies of 2014-2018 period is fluctuating. Profitability is experiencing an increase. Whereas leverage and liquidity tend to decrease. Influence of profitability, leverage and liquidity to financial distress on retail companies listed on the 2014-2018 period Indonesian Stock Exchange is as follows:

Profitability, leverage and liquidity were jointly significant influential to financial distress on retail companies listed on the 2014-2018 period Indonesian Stock Exchange. Profitability was partially influential significant on financial distress in Indonesian Stock Exchange listed retail companies of 2014-2018 period, leverage partially influential significant on financial distress in Indonesian Stock Exchange listed retail companies of 2014-2018 period, and liquidity partially influential significant on financial distress on retail companies listed on Indonesian Stock Exchange of 2014-2018 period.

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